I urge you to support HB 5545, AAC a Comprehensive Study of the State's Tax Structure

Bill Cibes

House Chair, Committee on Finance, Revenue and Bonding, 1989-1991
Secretary, Office of Policy and Management, 1991-1994

March 17, 2014

I applaud the Committee for raising HB 5545, and I urge you – and ultimately the General Assembly – to support it. It complements the tax incidence study currently underway, as provided in Section 328 (b) of PA 13-247, by requiring the examination of all major taxes and specific questions related to each, in the context of widely accepted principles of taxation.

A. I particularly congratulate you for including, as provided in Section 1 (d) (5), a study of property taxes, which raise a far higher percentage (42%) of total state and local tax revenue than any other revenue source in the state,[1] and burden businesses more than any other tax.[2] High property taxes are a major reason why Connecticut's tax system is broken. So property tax relief would lessen the economic burden on businesses, municipalities, and individuals.

Property taxes are relatively stable. But when a state relies excessively on property taxes to fund important services like education, infrastructure, and public safety, businesses and individuals are punished.

The current property tax setup is unfair:

- Owners of properties – and cars – with the same fair market value pay vastly different property taxes based on which town they are in.
- Owners pay very different taxes for the same level of local public services.
- Owners receive very different levels of local public services for the same level of taxes paid.

The current property tax structure distorts efficient allocation of resources:

---

[1] According to the Tax Foundation, in Connecticut in 2010, property taxes constituted 42% of all state and local tax revenue, while individual income taxes produced 26.9%, sales taxes 25.1%, and corporate income taxes 2.4%. "The Sources of State and Local Tax Revenue," (January 29, 2013)

[2] According to the latest study of business taxes, produced by Ernst and Young for the Council on State Taxation in 2013 (using 2012 data), property taxes constituted 27.7% of taxes paid by businesses in Connecticut, while sales taxes were 24.0% of businesses' tax burden, excise taxes 15.4%, unemployment insurance taxes 10.7%, individual income taxes on pass through income 9.9%, corporate income taxes 8.1%, and license and other taxes 4.3%. "Total State and Local Business Taxes: state by state estimates for fiscal year 2012," July 16, 2013.

- Different tax levels in different municipalities spur households and businesses to move from one community to another simply to lower tax burdens.
- Because towns with lower tax burdens are likely to be at some distance from central cities, new lower density development is encouraged at the expense of preserving open space and farmland while weakening core cities.
- Spread out communities consume more energy per resident, losing the energy efficiencies of denser communities.
- Additional automobile miles driven – to work, to shop, to play, to home – generate additional pollution and fuel consumption.
- Private, municipal and state resources are wasted to build and maintain essentially duplicate infrastructure that exists in other communities – churches, power lines, fiber optic cables, schools, roads, water and sewer lines.
- Public services – fire, police and emergency response – cost more when there is much duplication.
- As global economic trends cause the abandonment of "big box" stores and office buildings, once sought to lower local property taxes, municipalities reliant only on property taxes come under severe fiscal pressure.

Your proposed study of the property tax provides for a review and analysis of all of these impacts. (lines 54 - 56)

Moreover, your study provides for an examination of alternative sources of revenue for municipalities. (line 57) I would urge you to require that this study specifically look at additional state aid to municipalities as the alternative source.

First of all, the study should look at the possibility of leveling the playing field by requiring the state to fully fund its PILOT programs for (a) state property and (b) tax-exempt colleges and hospitals. Why should individual towns bear the cost of providing services to state government and private institutions that provide regional and statewide benefits, essentially subsidizing non-residents by placing the burden on town residents?[3]

Second, the study should examine requiring the state to pay for the major, if not the entire, cost of special education, and developing a formula to equalize the ability of towns to fund the other costs of public education.

Third, the study should fully investigate a framework for providing new state aid to fairly and equitably close the "need-capacity gap," – "the gap between the underlying costs of providing [non-educational] local public services ("costs") and the ability to raise revenue locally to pay for those services ("capacity")." The New England Public Policy

---

[3] An eloquent argument in favor of PILOT payments was provided by Professor Richard Pomp, in testimony to the Finance Committee in the 1970s supporting the extension of PILOT payments to tax-exempt private institutions. Testimony printed in "Tax-Exempt Property and the Cities," in the Journal of Real Estate Taxation (1978), reprinted in <u>State and Local Tax Revolt: New Directions for the 80's. (1980)</u>

Center (NEPPC) at the Federal Reserve Bank of Boston has developed such a framework to create a formula for Massachusetts[4] that could potentially be used in Connecticut to direct new unrestricted state aid to towns and cities in ways that promote equity and efficiency and diminish property tax disparities. As the originators of this approach state, "For police, fire, and other local services, grants based on the need-capacity gap provide a flexible way to focus aid on the jurisdictions that, through no fault of their own, need help the most."[5]

To summarize the NEPPC's recommendations:

- Because not all municipalities have the capacity to increase property taxes to the level needed to invest in priority services and infrastructure, new state aid should be provided based on the real needs of towns, as measured by factors outside the control of local officials, potentially including population density, poverty rate, unemployment rate, and jobs per capita.
- The measures of both need and capacity should be based on factors <u>not</u> within the direct control of local officials, so neither wasteful spending is rewarded nor efficient management punished. Local decisions to pay employees a higher wage or to hire more employees or to provide a higher than average level of services (on the cost side), and local decisions to raise or lower tax rates (on the capacity side) should not be included in the gap analysis. Instead factors like population density, poverty rate, unemployment rate and jobs per capita could be used to measure municipal need. And taxable property value and local residents' income could be measures of municipal capacity.
- New state aid to provide property tax relief can be phased in over a period of years.

B. Reforming the property tax cannot be accomplished in the absence of a rethinking of the entire revenue structure of the state. So looking beyond the proposed examination of the property tax, it is high time that the General Assembly once again conduct a comprehensive study of other revenue sources – as is provided in this bill.

It has been a quarter century since the last comprehensive examination of Connecticut's tax structure by a similar broad-based task force.[6] In 1990-1991, facing

[4] See Zhao (and others), "Does Springfield Receive Its Fair Share of Municipal Aid? Implications for Aid Formula Reform in Massachusetts." Federal Reserve Bank of Boston, Community Development Discussion paper, July 2010; Zhao and Coyne, "Reforming Municipal Aid in Massachusetts: The Case for a Gap-Based Formula," NEPPC Policy Brief 10-2 (December 2010); Zhao, "Municipal Aid Evaluation and Reform," NEPPC Working Paper 11-1 (June 2011 version); Coyne and Zhao, "Making Municipal Aid Count: Mind the Gap!" *Communities and Banking*, Spring 2011.

[5] Ladd and Yinger, "The Case for Equalizing Aid," in 47 *National Tax Journal* 211-224 (March 1994), at p. 220.

[6] Another, more recent study, is also an extremely valuable resource: "Connecticut's Tax System," published in January 2006 by the Legislative Program Review and Investigations Committee, which can be accessed through the link at http://www.cga.ct.gov/pri/2005.asp#05Connecticuts_Tax_System

potential deficits of epic proportions, the General Assembly created and funded an analysis of three potential sources of revenue to fund investments in Connecticut's future. As is proposed by HB 5545 for the current effort, the Finance Committee served as the core overseer of that project, created at the urging of then-Representative Miles Rapoport, now national chairman of Common Cause. The study produced three landmark reports, each supported by analysis by a major national accounting firm (Coopers and Lybrand, and KPMG Peat Marwick), on the sales tax, the personal income tax, and the corporate income tax. The studies, copies of which are in the archives of the General Assembly's Legislative Library, are models of non-partisan, objective analysis by national experts in the field of taxation, responding to questions raised and comments made by the members of the oversight group.

I think that there were several distinctive characteristics of the 1990-1991 study which should provide guidance as you craft the current effort:

- The membership of the oversight group was not limited to the members of the Finance Committee, but extended to experts in the field of taxation (from academia and legal firms specializing in taxation) and representatives of major interested parties.
- The oversight group was chaired by the co-chairs of the Finance Committee, and included many (if not all (I simply don't recall)) members of the Finance Committee, to ensure that ramifications for public policy were considered.
- Because it was simply not realistic to expect that the experts who were members could afford to provide *pro bono* services to the extent that thorough analysis required, outside consultants were necessary.
- Although the oversight group received extremely valuable guidance and assistance from staff members of OFA, PRI, OPM and DRS, the resources of those organizations were not sufficient to provide the detailed expertise required.
- There was funding adequate to secure the services of <u>national</u> firms that had comprehensive expertise in the field of taxation.
- The national firms were selected through a standard competitive process, including an RFP and extensive interviews.

So based on my experience as co-chair of the 1990-1991 study, I want to emphasize the many positive aspects of HB 5545, and then make some suggestions for clarification and improvement.

A. Positive Aspects

1. The goals of the study, as reflected in lines 7- 8 and 25 -26, laudably reflect <u>many</u> of the NCSL's principles of a fair revenue system.[7] See below for additional recommendations.
2. The study will be chaired by the chairs of the Finance Committee.
3. The study will draw upon the support of OPM and DRS.

[7] The 2006 PRI study uses these NCSL goals as a template for its analysis. See pages 9 - 29.

4. By convening a panel of experts, there is a recognition that the topics to be addressed require information, knowledge and expertise more detailed than most legislators possess.
5. By providing an appropriation of $500,000, there is a recognition that, to pay for needed expertise, more than token funding is required. (But see below.)

B. Recommendations for Improvement

1. Given the projected need for additional revenue to help reduce or eliminate future deficits, and for additional revenue at the state level to support the limited revenue-raising capacity of local governments in the state, the study should not be limited to "revenue-neutral" options. (lines 5 - 6)
2. The study should <u>include</u> "a panel of experts" (line 4), but it should be overseen not just by such a panel, but by many members, if not all of, the members, of the Finance Committee.
3. In addition to the goals of the study as enumerated on lines 7 - 8 and 25 - 26, the study should also examine whether the tax structure of the state meets goals of sufficiency, balance, accountability, fair and efficient administration and complementarity. Indeed, the complete list of NCSL goals should be included as goals of this study, as it was in the 2006 LPRI study.
4. There should be explicit recognition – supplementing the language of lines 18 - 19 – that the study's oversight group should be able to hire outside national consultants, through a competitive RFP process, to provide all the unbiased, impartial expertise that will be required. Fortunately, there is an implicit recognition, in Section 2 of the bill (lines 79 - 81) of the necessity of this support.
5. However, $500,000 is probably not sufficient to bring the expertise of national firms to bear on the many questions that are required to be examined. (The tax incidence study currently underway is projected to cost $700,000.)

C. To conclude, let me once again express my support for this needed analysis. State legislators are public policy generalists. They need the assistance of experts to delve into the intricacies of such complicated policy issues as taxation, and even the experts need sophisticated analytic capacities and expertise of accounting and legal firms with a national practice. Without this assistance, government is flying blind – almost as if someone pulled the instrument panel out of a 747 and expected the pilot to land the plane safely.